No. 88

In the Supreme Court of the United States

OCTOBER TERM, 1944

ELLA F. FONDREN AND THE ESTATE OF W. W. FONDREN, DECEASED, ELLA F. FONDREN, INDEPENDENT EXECUTRIX, PETITIONERS

v.

COMMISSIONER OF INTERNAL REVENUE

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF FOR THE RESPONDENT

INDEX

CITATIONS

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OPINIONS BELOW

The opinion of the Tax Court (R. 28–36) is reported at 1 T. C. 1036. The opinion of the Circuit Court of Appeals (R. 71–78) is reported at 141 F. 2d 419.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered March 3, 1944. (R. 78.) The petition for a writ of certiorari was filed May 19, 1944, and was granted on October 9, 1944. The jurisdiction of this Court is invoked under Sec-

tion 240 (a) of the Judicial Code as amended by the Act of February 13, 1925.

QUESTION PRESENTED

In 1937 the taxpayer and her husband made gifts to each of seven trusts which they had previously established in favor of seven minor grandchildren. Each trust instrument provided that the corpus and accumulated income were to be distributed in portions as the beneficiary reached the ages 25, 30, and 35 years, and also that, if necessary, the trustee was to provide for the support, maintenance, and education of the beneficiary, using only the income of the trust if that were sufficient. The question is whether the gifts were of future interests within the meaning of Section 504 (b) of the Revenue Act of 1932, so that the $5,000 exclusion otherwise allowable with respect to each gift must be denied.

STATUTE AND REGULATIONS INVOLVED

Revenue Act of 1932, c. 209, 47 Stat. 169:

> SEC. 504. NET GIFTS.
>
> (a) *General Definition.*—The term "net gifts" means the total amount of gifts made during the calendar year, less the deductions provided in section 505.
>
> (b) *Gifts Less Than $5,000.*—In the case of gifts (other than of future interests in property) made to any person by the donor during the calendar year, the first $5,000 of such gifts to such person shall not, for the

purposes of subsection (a), be included in the total amount of gifts made during such year.

Treasury Regulations 79 (1936 Ed.):

> ART. 11. *Future interests in property.*—No part of the value of a gift of a future interest may be excluded in determining the total amount of gifts made during the calendar year. "Future interests" is a legal term, and includes reversions, remainders, and other interests or estates, whether vested or contingent, and whether or not supported by a particular interest or estate, which are limited to commence in use, possession, or enjoyment at some future date or time. * * *

STATEMENT

The taxpayer, on her own behalf and also as executrix of her husband's estate, petitioned the Tax Court to redetermine deficiencies found by the Commissioner in the gift taxes of the taxpayer and her husband for 1937. The facts were stipulated (R. 42-64), and as stipulated were adopted as the findings of fact of the Tax Court (R. 29). They may be summarized as follows:

During 1935, 1936, and 1937 the taxpayer and her husband executed seven trust instruments, one in favor of each of their seven grandchildren. (R. 30.) On or about December 2, 1937, the taxpayer and her husband each made a gift to each trust of 100 shares of Humble Oil & Refining

Company stock having a fair market value at that time of $59.75 a share. (R. 33.) On their gift tax returns for 1937 the taxpayer and her husband each claimed the statutory exclusion of $5,000 for each of his seven gifts, reported a taxable gift to each trust of $975, and paid gift taxes on the basis reported. (R. 33.) The Commissioner determined that the gifts in trust constituted gifts of future interests in property against which no exclusions are allowable, and he accordingly disallowed the exclusions. (R. 34.)

The Tax Court found that the gifts made by the taxpayer and her husband to the trust estates were gifts of future interests (R. 34) and sustained the Commissioner's determinations of deficiency. The Circuit Court of Appeals affirmed the Tax Court's decision (R. 78).

None of the grandchildren was over six years of age at the time the trust was created for him. All were living when this proceeding was heard. Each trust instrument made W. W. Fondren trustee. Upon his death in 1939, the taxpayer succeeded to the trusteeship and has since administered each trust as trustee. (R. 30.)

So far as here pertinent, the provisions of the seven trust instruments are the same. (R. 30.) The trusts are absolute and irrevocable and the grantors neither received nor retained any interest in the estate or the benefits accruing therefrom. (R. 33, 58.)

The stated purpose in creating each trust is "to provide for the personal comfort, support, maintenance and welfare of" each grandchild. (R. 57.) The trust is to continue until the beneficiary attains the age of 35, but 25% of the corpus and accumulations, if any, are to be delivered to the grandchild when he or she attains the age of 25, 33⅓% when he or she attains the age of 30, and the remainder when he or she attains the age of 35. (R. 55.) If the beneficiary dies leaving issue before termination of the trust, the trust estate is to be held and administered for the benefit of the issue and delivered share and share alike when the youngest of such issue attains the age of 21. If the beneficiary dies without issue before termination of the trust, successor beneficiaries are provided for by the trust instrument, or the trust estate descends to the heirs of the successor beneficiaries under the laws of the State of Texas. (R. 32, 56.)

Article Three of the trust instrument provides (R. 31–32, 54–55):

> Out of the trust estate hereby created and as the same may hereafter be augmented and increased by gifts from the Grantors, by either of them as herein provided for, or from any other source whatsoever, the Trustee shall provide for the support, maintenance and education of our said Grandson, [or Granddaughter as the case may be] using only the income of said es-

tate for that purpose if it be sufficient. If it be necessary to use any of the corpus of the estate for that purpose and in the judgment of the Trustee it is best to do so, said Trustee may make advancements out of the corpus of said trust estate for such purpose for the benefit of our said Grandson.

It is contemplated, however, that our said Grandson will have other adequate and sufficient means of support, and that it will not be necessary to use either the income or the corpus of the trust estate hereby created to properly provide for his education, maintenance and support; and, if the income from the trust estate be not needed for these purposes, then all of the income from said trust estate not so needed shall be by the Trustee passed to capital account of said trust estate, and shall be and become a part of said trust estate, it being our hope that all of the earnings and income of said trust estate during the period of this Trust may be used to augment the trust estate and be delivered to our said Grandson at the periods herein provided for. It is expressly provided, however, that our said Grandson shall be properly maintained, educated and supported, and if it be necessary to use all of the income and even all of the corpus of the trust estate hereby created and all augmentations thereof, it shall be the duty of the Trustee to see that this obligation shall be properly and reasonably discharged.

* * * * *

The trust funds are not to be liable for obligations of the beneficiaries. A beneficiary may not anticipate his or her interest in the trust fund created for him and the fund may not be reached by judgment creditors or others having claims against the beneficiary. (R. 32–33, 57–58.)

At all times subsequent to the creation of the trusts, the parents of the named beneficiaries have adequately and sufficiently provided for the support, maintenance, and education of their children. As a result, no part of the trust income or corpus has been distributed or used for the benefit, support, maintenance, or education of any of the beneficiaries of the seven trusts. (R. 34.)

SUMMARY OF ARGUMENT

Prior to a recent decision of the Circuit Court of Appeals for the Third Circuit, overruling its own earlier decision, the rule had become well settled that a gift in trust to accumulate income and to pay the corpus and accumulations to the beneficiary at a future time is a gift of a future interest, as to both income and corpus, even though the accumulation is to continue only during the disability of the beneficiary and even though the trustee may be authorized to pay the income or corpus to the beneficiary if in his judgment it should become necessary to do so for the beneficiary's maintenance, education or support. The rule has apparent confirmation in Con-

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gressional re-enactment of the provisions permitting exclusions with respect to gifts in trust, after the rule had been uniformly applied in a number of Circuit Court of Appeals' decisions. The rule, moreover, is a correct application of decisions of this Court, which establish that the interest taken by the beneficiary rather than the interest parted with by the donor is controlling. Under those decisions the question turns solely on whether the beneficiary takes a present right to the use, possession or enjoyment of the thing given. Unless the donee can require payment from the trustee presently, it is not material that the donee may have present rights of a character which a court of law or equity will recognize, nor do present expectancies of future payment constitute such "enjoyment" as to render a gift a present one. Under the trusts in the present case it was expressly contemplated that the beneficiaries would have other and adequate means of support, and the trustee was not to pay over corpus or income to the beneficiaries except in the uncertain contingencies that the beneficiaries would need money for the designated purposes which would not be forthcoming from their parents who had the primary duty of support. The contention that under the Commissioner's theory no gift to minors could be made, other than one of a future interest, is without substance. Gifts to minor beneficiaries are placed

on an equality with gifts to adults by applying to both the principle that a right to receive the gift only upon the exercise of discretion is a gift of a future interest.

ARGUMENT

THE INTERESTS GIVEN IN THE PRESENT CASE WERE FUTURE INTERESTS

Until recently the term "future interests" as it relates to the present type of case had been uniformly applied and had a settled meaning indicated by the decisions of this Court in *Ryerson* v. *United States*, 312 U. S. 405, and *United States* v. *Pelzer*, 312 U. S. 399. The only Circuit Court of Appeals decision which departs from the uniform application of the rule is that in *Disston* v. *Commissioner*, 144 F. 2d 115 (C. C. A. 3d), Judge Biggs dissenting, which overruled the same court's prior decision in *Commissioner* v. *Taylor*, 122 F. 2d 714, 715, certiorari denied, 314 U. S. 699. The *Disston* case is pending in this Court upon petition for a writ of certiorari filed on behalf of the Commissioner on October 12, 1944, No. 589.

Except for the decision in the *Disston* case the Circuit Courts of Appeals have uniformly held that a gift in trust to accumulate income and pay the corpus and accumulations to the beneficiary at a future time is a gift of a future interest, as to both income and corpus, notwithstanding that the trustee may have discretion to

pay the income or corpus to the beneficiary if it should become necessary to do so for his maintenance, education or support or upon some similar contingency. The same rule has been applied whether the donees were minors or adults. *Welch* v. *Paine*, 120 F. 2d 141 (C. C. A. 1st); *Commissioner* v. *Taylor*, 122 F. 2d, 714, 715 (C. C. A. 3d), certiorari denied, 314 U. S. 699; *Commissioner* v. *Brandegee*, 123 F. 2d 58 (C. C. A. 1st); *Commissioner* v. *Phillips' Estate*, 126 F. 2d 851 (C. C. A. 5th); *Commissioner* v. *Gardner*, 127 F. 2d 929 (C. C. A. 7th); *Welch* v. *Paine*, 130 F. 2d 990 (C. C. A. 1st); *Commissioner* v. *Wells*, 132 F. 2d 405 (C. C. A. 6th); *French* v. *Commissioner*, 138 F. 2d 254 (C. C. A. 8th); *Roberts* v. *Commissioner*, 143 F. 2d 657 (C. C. A. 5th), petition for certiorari filed by the taxpayer October 6, 1944;[1] *Howe* v. *United States*, 142 F. 2d 310 (C. C. A. 7th), petition for certiorari filed by the taxpayer September 6, 1944; *Hutchings-Sealy Nat. Bank* v. *Commissioner*, 141 F. 2d 422 (C. C. A. 5th); *Helvering* v. *Blair*, 121 F. 2d 945 (C. C. A. 2d). The Tax Court has applied the same rule in cases like the present case in six decisions in the past year alone.[2]

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[1] The discretionary aspect of the duties of the trustee in the *Roberts* case appears more fully in the opinion of the Tax Court, 2 T. C. 679, 687.

[2] *Allen* v. *Commissioner*, 3 T. C. 844 (decided after *Disston* v. *Commissioner*, *supra*, and disagreeing with the conclusion there reached); *Scherer* v. *Commissoner*, 3 T. C. 776, 791; *Nicholson* v. *Commissioner*, 3 T. C. 596, 601; *Stoll* v. *Commis-*

Moreover, the rule has apparent confirmation by Congress. In Section 505 of the Revenue Act of 1938, c. 289, 52 Stat. 447, Congress amended Section 504 (b) of the 1932 Act, *supra*, to withdraw the $5,000 exclusion entirely from gifts in trust. This action was occasioned by the fact that the Board of Tax Appeals and several of the Federal courts had decided, prior to this Court's contrary decision in *Helvering* v. *Hutchings*, 312 U. S. 393, that the trust entities were the donees, a result which involved serious possibilities of tax avoidance.[7] The exclusion, reduced to $3,000, was restored to gifts in trust in the Revenue Act of 1942, c. 619, 56 Stat. 798, Section 454, for the reason that the decision in *Helvering* v. *Hutchings*, *supra*, removed the pos-

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sioner, decided August 7, 1944 (1943–1944 P-H Tax Court Memorandum Decisions Service, par. 44,261); *Richardson* v. *Commissioner*, decided November 30, 1943 (id., par. 43,496); *Weathers* v. *Commissioner*, decided September 21, 1943 (id., par. 43,428).

[7] The Senate Finance Committee, with which the amendment originated, stated (S. Rep. No. 1567, 75th Cong., 3d Sess., p. 41 (1939–1 Cum. Bull. (Part 2) 779)):

"The committee is also proposing an amendment by which the exclusion would not apply to gifts in trust. The Board of Tax Appeals and several of the Federal courts have held, with respect to gifts in trust, that the trust entities were the donees and on that account the gifts were of present and not of future interests. The statute, as thus construed, affords ready means of tax avoidance, since a donor may create any number of trusts in the same year in favor of the same beneficiary with a $5,000 exclusion applying to each trust, whereas the gifts, if made otherwise than in trust, would in no case be subject to more than a single exclusion of $5,000."

sibility of gift tax avoidance of which Congress had been apprehensive.[4] The Revenue Act of 1942 was approved on October 21, 1942, after Circuit Courts of Appeals had uniformly decided in *Welch* v. *Paine*, 120 F. 2d 141, and the *Taylor, Brandegee Phillips'* and *Gardner* cases, *supra*, that a trustee's discretionary power to distribute income does not render the gift of the income a present interest. This also had been the conclusion of the Board of Tax Appeals, for example in *Winterbotham* v. *Commissioner*, 46 B. T. A. 972. In relation to a subject with respect to which judicial decisions had caused so much concern, it must be supposed that Congress was aware of the decisions and confirmed their result. *United States* v. *Ryan*, 284 U. S. 167; cf. *White* v. *Winchester Club*, 315 U. S. 32, 40.

The decisions in *Smith* v. *Commissioner*, 131 F. 2d 254 (C. C. A. 8th); *Sensenbrenner* v. *Commissioner*, 134 F. 2d 883 (C. C. A. 7th); and *Kinney* v. *Anglim*, 43 F. Supp. 431 (N. D. Cal.), appeal dismissed on stipulation, 127 F. 2d 291 (C. C. A. 9th) (Pet. Br. 23–24, 36–37), are not departures

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[4] S. Rep. No. 1631, 77th Cong., 2d Sess., p. 243:
"Since the Supreme Court has decided, in *Helvering* v. *Hutchings* (312 U. S. 365 (1941)), that the beneficiaries of the trust rather than the trustee or the trust are the donees of a gift in trust, it is no longer necessary to discriminate against gifts in trust by disallowing the exclusion in such cases (except in cases of gifts of future interests in property) to prevent gift tax avoidance through the device of multiple trusts for the same beneficiary."

from the general rule stated above. In the *Kinney* and *Sensenbrenner* cases the income was to be paid over currently or quarterly without any discretion in the trustee to withhold. For that reason the *Kinney* case held the gift to be of a present interest. In the *Sensenbrenner* case the Government conceded the gift to be of a present interest with respect to the income because the income was to be disbursed currently for the beneficiaries, and the court held the gift to be of a future interest with respect to the corpus, as the Government contended. In the *Smith* case the decision rested upon the holding that the beneficiaries were entitled to the immediate use and enjoyment of the trust income.[5] This is evident from the same court's later decision in *French* v. *Commissioner, supra,* holding that a future interest was involved where the trustee had discretion to accumulate or distribute the income. In the latter case the court stated, at page 258, that there was no such provision for the trustee's discretion in the *Smith* case.

We believe that the decision in *Disston* v. *Commissioner,* 144 F. 2d 115 (C. C. A. 3d), is based

[5] This view was based upon the court's conception of the dominant purpose of the settlor and is of questionable validity. The case has been criticized as resting "on an insecure foundation." *Fisher* v. *Commissioner*, 132 F. 2d 383, 386 (C. C. A. 9th). However, notwithstanding doubt concerning the validity of the court's premise, the conclusion was based upon the application of the legal principle for which we contend.

upon a misapprehension of the term "future interests" and the background of its use in Section 504 (b) of the Revenue Act of 1932.

Section 501 of the Act imposes a tax upon gifts, the amount of which is determined under Section 502 by computing the tax on the sum of the net gifts made by the donor in the calendar year and preceding years, and deducting from that tax a tax computed upon the sum of the net gifts made in the preceding years. The donor is given a specific exemption of $50,000 under Section 505 (a) (1), which he may allocate against his gifts from year to year as he sees fit until the exemption is exhausted. In computing his "net gifts" for any calendar year the donor deducts so much of the specific exemption as he claims for that year, together with the amount of gifts to charity and for other purposes permitted in Section 505 (a) (2). He is also entitled, under Section 504 (b), to the exclusion here in issue of the first $5,000 of the gift made to any donee during the calendar year, other than one of future interests in property.

The purpose of the exclusion is simply to avoid the burden of recording and reporting numerous small gifts, which would be disproportionate to the amount of revenues produced. The amount of the exclusion is made sufficiently large to cover most cases of wedding and Christmas gifts and also occasional gifts of relatively small amounts.

H. Rep. No. 708, 72d Cong., 1st Sess., p. 29 (1939–1 Cum. Bull. (Part 2) 457). The amount of the exclusion was reduced to $4,000 in the Revenue Act of 1938, c. 289, 52 Stat. 447, Section 505, before its reduction to $3,000 in the Revenue Act of 1942, Section 454, *supra*. The report of the House Committee relating to the latter Act indicates that the exclusion would be abolished completely except for the administrative difficulties which would arise if that were done.[6] In short, the legislative purpose in permitting the exclusion suggests no reason for abandoning with respect to it the ordinary canon that tax exemptions are not to be extended by construction. *Helvering* v. *Northwest Steel Mills*, 311 U. S. 46, 49; *Helvering* v. *American Dental Co.*, 318 U. S. 322, 329–330.

It should be observed that while the apprehended difficulty of valuing future interests as to each donee and determining the number of eventual donees suggested the need for different treatment of future interests, the class thus treated is not limited to instances in which this difficulty arises. Congress realized that the difficulty would

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[6] H. Rep. No. 2333, 77th Cong., 2d Sess., p. 37:

"Since this is an annual exclusion (not exhaustible as is the specific exemption) and is not limited to any number of donees, it is possible to distribute property of large aggregate value over a period of years, free not only of gift tax but of estate tax as well. While administrative difficulties prevent the abolition of the exclusion, your committee recommend that it be reduced to $3,000."

not be presented in all the cases which were covered by the rule enacted, for the committee reports use the qualifying phrase "in many instances" (H. Rep. No. 708, *supra*). The statutory exception is in general language and thus includes all gifts of "future interests in property." *Fisher* v. *Commissioner*, 132 F. 2d 383 (C. C. A. 9th); *Commissioner* v. *Glos*, 123 F. 2d 548 (C. C. A. 7th); *Welch* v. *Paine*, 120 F. 2d 141 (C. C. A. 1st). Accordingly, the opinion in the *Disston* case, insofar as it rests upon the fact that the identity of the donees and the value of the gifts were not affected by the trustee's discretionary power in that case, rests upon an erroneous ground.[7] Nor is there anything in the term "future interests" or in the purposes of the exclusion to suggest that interests conferred upon minor beneficiaries are "future" for that reason or are different from the same interests when conferred upon others. This is recognized by the Third Circuit in *Wisotzkey* v. *Commis-*

[7] In point of fact, there is no method of evaluating any suppositious present rights of the beneficiaries in the present type of case. As stated by Judge Biggs, dissenting, in *Disston* v. *Commissioner*, *supra*, p. 120:

"* * * the trustees are the judges (in the first instance) of how much of the income from the gift [and here, how much of the corpus] is to be expended for the immediate benefit of the minors. That amount might be much or little as justified by the circumstances of the particular minor involved and it is impossible to determine the value of the present right or even to allocate it to the first $5,000 in value of the gift. See *Helvering* v. *Blair*, 2 Cir., 121 F. 2d 945, 947."

sioner, decided August 10, 1944 (1944 P-H, par. 62,695), after the *Disston* case, in which a trust involving a mandatory accumulation of income throughout the beneficiary's minority was held to be a gift of a future interest.

The majority opinion in the *Disston* case calls attention to the exclusive nature of the donees' interest under the trusts there involved. The dissenting opinions of Judge Waller in the instant case and in *Hutchings-Sealy Nat. Bank* v. *Commissioner,* 141 F. 2d 422 (C. C. A. 5th), stress the conclusion that the gifts were absolute since both the income and the corpus were irrevocably dedicated to the named donees.[8] This factor alone is not controlling, however. *Hutchings-Sealy Nat. Bank* v. *Commissioner, supra.* It was held not to be controlling in the *Wisotzkey* case, where, in the event of the death of a beneficiary, his trust was to be administered for the benefit of his heirs or assigns. The decision in *Helvering* v. *Hutchings, supra,* holding that the beneficiaries, rather than the trust, are the donees of a gift in trust, necessarily implies that the character of the gift as "present" or "future" must be determined as of the time when the beneficiaries, rather than the trust, come into possession of the gift. The fact

[8] The present case is different upon its facts from the *Disston* case in that here the rights of the named donees, in the event of their death, might pass to successor beneficiaries (R. 32, 56) rather than to the heirs or representatives of the named donees.

that the gift is irrevocable has no significance. Under this Court's decisions in the *Ryerson* and *Pelzer* cases, *supra*, an interest plainly is not a present interest for tax purposes merely because the donee has vested rights which will be recognized by a court of law or equity, for there is the further requirement that he have a right to present use, possession, or enjoyment. *Commissioner* v. *Brandegee*, 123 F. 2d 58 (C. C. A. 1st); *Welch* v. *Paine*, 130 F. 2d 990 (C. C. A. 1st). Furthermore, the *Ryerson* and *Pelzer* cases make it clear that the economic satisfaction which the donee may derive from knowing that he will receive valuable property in the future is not the kind of present "enjoyment" which would make the gift one of a "present" interest.

As both of the courts below have held (R. 35–36, 73–74), there is no merit in the taxpayer's position that the trustee here had no discretion (Br. 32–37). It is particularly evident from Article 3 of the trusts (R. 54–55) that neither the income nor the corpus was likely to be received by the beneficiaries immediately. Their use, possession, or enjoyment could not begin until the happening of future contingencies—the beneficiaries must come to need money for their education, maintenance and support, and the other means of support which the grantors expressly contemplated must fail. Nor is there validity to the contention that the trustee here is in the same position as a guardian under state law.

The trustee was empowered to withhold payments during the minority of a beneficiary under circumstances, falling short of need, which might call upon a guardian to purchase advantages for his ward through the expenditure of income or principal belonging to the ward. Moreover, regardless of the extent of the trustee's discretion, the future and contingent nature of the interest of the beneficiaries is evident from the fact that whereas a child's estate or his parent is primarily charged with the burden of his support, distribution of the trust estate could not be compelled unless these primary sources failed. *Welch* v. *Paine*, 130 F. 2d 990, 992 (C. C. A. 1st); *Estate of Smith*, 23 Cal. App. 2d 383.

It is not true, as suggested in the dissenting opinion in the court below, that under the Commissioner's theory there would be no other way to make a gift to a minor than through the creation of a future interest. Even if this were true, there would still be no valid reason for treating a future interest as a present interest. But the proposition is unsound. A gift of a present interest is possible even by means of a trust. See *Fisher* v. *Commissioner*, 132 F. (2d) 383 (C. C. A. 9th), and *Kinney* v. *Anglim*, 43 F. Supp. 431 (N. D. Cal.), appeal dismissed on stipulation, 127 F. 2d 291 (C. C. A. 9th), in which the trustees were to pay the income to the parents of the minor beneficiaries and the gifts of income were treated as present gifts.

Gifts to minor beneficiaries are placed on an equality with gifts to adults by applying to both the principle that a right to receive the gift only upon the exercise of a trustee's discretion is a gift of a future interest.

CONCLUSION

We submit that the decision below correctly follows the established rule and that the judgment should be affirmed.

Respectfully submitted.

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SUPREME COURT OF THE UNITED STATES.

No. 88.—October Term, 1944.

Ella F. Fondren, and the Estate of W. W. Fondren, Deceased, et al., Petitioners,
vs.
Commissioner of Internal Revenue.

On Writ of Certiorari to the United States Circuit Court of Appeals for the Fifth Circuit.

[January 29, 1945.]

Mr. Justice Rutledge delivered the opinion of the Court.

In 1935, 1936 and 1937 petitioner, Ella F. Fondren, and her husband, since deceased, created seven separate irrevocable trusts, each in favor of a grandchild of tender years, and each of them made gifts to each trust of corporate stock having the fair market value of $5,975. The donors made gift tax returns for 1937, claiming the statutory exclusion of $5,000 for each gift, and accordingly reported taxable gifts for each trust of $975. Gift taxes were paid on this basis.

The Commissioner made deficiency assessments, disallowing the exclusions on the ground that the gifts were of "future interests in property" within the meaning of the Revenue Act of 1932, c. 209, 47 Stat. 169, and Treasury Regulations 79 (1936 ed.)[1] The Tax Court upheld the Commissioner, the cases being consolidated for hearing and decision. 1 T. C. 1036. The Circuit Court of Appeals affirmed the Tax Court's decision, one judge dissenting. 141 F. 2d 419. Certiorari was granted, 323 U. S. —, because of the importance of the question as affecting the taxability of gifts made for the benefit of minor children and because of alleged or apparent conflict with decisions of other courts.[2]

[1] The statute is as follows:

"Sec. 504. Net Gifts.

"(a) *General Definition.*—The term 'net gifts' means the total amount of gifts made during the calendar year, less the deductions provided in section 505.

"(b) *Gifts Less Than $5,000.*—In the case of gifts (other than of future interests in property) made to any person by the donor during the calendar year, the first $5,000 of such gifts to such person shall not, for the purposes of subsection (a), be included in the total amount of gifts made during such year."

The pertinent part of the Regulation is quoted in the text below.

[2] The petition alleged conflict with Smith v. Commissioner, 131 F. 2d 254 (C. C. A. 8th); Sensenbrenner v. Commissioner, 134 F. 2d 883 (C. C. A. 7th); and Kinney v. Anglim, 43 F. Supp. 431 (N. D. Calif.). Cf. also

The sole issue is whether the gifts were of "future interests" within the meaning of the statute and the regulation. The latter provides:

> Art. 11. . . . "Future interests" is a legal term, and includes reversions, remainders, and *other interests or estates*, whether vested or contingent, and whether or not supported by a particular interest or estate, *which are limited to commence in use, possession, or enjoyment at some future date or time.* . . . [Emphasis added]

Upon the facts the issue turns on whether the interests acquired by the minor beneficiaries were "limited to commence in use, possession, or enjoyment at some future date or time." *Rgerson* v. *United States*, 312 U. S. 405; *United States* v. *Pelzer*, 312 U. S. 399.

Under these decisions it is not enough to bring the exclusion into force that the donee has vested rights. In addition he must have the right presently to use, possess or enjoy the property. These terms are not words of art, like "fee" in the law of seizin, *United States* v. *Pelzer*, *supra* at 403, but connote the right to substantial present economic benefit. The question is of time, not when title vests, but when enjoyment begins. Whatever puts the barrier of a substantial period between the will of the beneficiary or donee now to enjoy what has been given him and that enjoyment makes the gift one of a future interest within the meaning of the regulation.

Accordingly, it has been held that if the income of a trust is required to be distributed periodically, as annually, but distribution of the corpus is deferred, the gift of the income is one of a present interest, that of the corpus one *in futuro*. *Fisher* v. *Commissioner*, 132 F. 2d 383; *Sensenbrenner* v. *Commissioner*, 134 F. 2d 883. *A fortiori*, if income is to be accumulated and paid over with the corpus at a later time, the entire gift is of a future interest,[3] although upon specified contingency some portion or all of the fund may be paid over earlier.[4] The contingency may be the exercise of the trustee's discretion, either absolute or con-

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Disston v. Commissioner, 144 F. 2d 115 (C. C. A. 3d). The decision, one judge dissenting, overruled the prior decision in Commissioner v. Taylor, 122 F. 2d 714, cert. denied, 314 U. S. 699. A petition for writ of certiorari was filed in the Disston case on October 12, 1944, and now is pending.

[3] Welch v. Paine, 120 F. 2d 141; Commissioner v. Taylor, 122 F. 2d 714, 715, cert. denied, 314 U. S. 699; Commissioner v. Brandegee, 123 F. 2d 58; Commissioner v. Phillips' Estate, 126 F. 2d 851; Commissioner v. Gardner, 127 F. 2d 929; Welch v. Paine, 130 F. 2d 990; Commissioner v. Wells 132 F. 2d 405; French v. Commissioner, 138 F. 2d 254; Roberts v. Commissioner, 143 F. 2d 657; Howe v. United States, 142 F. 2d 310; Hutchings-Sealy Nat. Bank v. Commissioner, 141 F. 2d 422; Helvering v. Blair, 121 F. 2d 945.

[4] *Ibid.*

tingent.[5] It may also be the need of the beneficiary, not existing when the trust or gift takes effect legally, but arising later upon anticipated though unexpected conditions, either to create a duty in the trustee to pay over or to permit him to do so in his discretion.[6]

In the light of these principles and decisions, it is necessary to consider the terms of the trusts and the circumstances in which the gifts were made. The trust instruments were substantially uniform except for variations in the names of the beneficiaries and, in case of death, their successors in interest. The trusts were irrevocable, the donors retaining no beneficial interest in the estates. Each instrument named the donor, W. W. Fondren, as trustee, and Ella F. Fondren, the other donor, as successor trustee. They reserved the rights as donors to remove any trustee, except Mr. Fondren, and to name successor trustees. Subject to these reservations and the directions set forth below, the trustee was given substantially complete control.

The trusts' stated purpose was "to provide for the personal comfort, support, maintenance, and welfare" of the grandchildren. But from the explicit recitals of the instruments,[7] as well as the evidence, including a stipulation, it is clear that the parents of each child were so situated that, when the gifts were made, they were fully able to provide for and educate him. And, from the same recitals, it is clear there was little reason to believe that any parent would not continue so until the child's majority. Accordingly, in each instance, the trust was to continue until the child should attain the age of thirty-five. Hence also the income was to be accumulated, except upon the contingencies specified below, and each beneficiary was to receive 25 per cent of the corpus and accumulations at age twenty-five, 33 1/3 per cent at age thirty, and the remainder at age thirty-five.

Aware of the uncertainties of our world, however, the donors directed in Article 3:

> . . . [T]he Trustee shall provide for the support, maintenance and education of our said Grandson, using only the income of said estate for the purpose if it be sufficient. If it be necessary to use any of the corpus of the estate for that purpose *and in the judgment of the Trustee it is best to do so*, said Trustee *may make ad-*

[5] Welch v. Paine, 120 F. 2d 141; Commissioner v. Taylor, 122 F. 2d 714, 715, cert. denied, 314 U. S. 699; Commissioner v. Brandegee, 123 F. 2d 58; Commissioner v. Phillips' Estate, 126 F. 2d 851; Commissioner v. Gardner, 127 F. 2d 929; Winterbotham v. Commissioner, 46 B. T. A. 972; cf. Ryerson v. United States, 312 U. S. 405, 408.

[6] Cf. authorities cited note 3 *supra*.

[7] Cf. the recitals quoted in the text below.

vancements out of the corpus of said trust estate for such purpose for the benefit of our said Grandson.

It is contemplated, however, that our said Grandson will have other adequate and sufficient means of support, and that it will not be necessary to use either the income or the corpus of the trust estate hereby created to properly provide for his education, maintenance and support; and, if the income from the trust estate be not needed for these purposes, then all of the income from said trust estate not so needed shall be by the Trustee passed to capital account of said trust estate, and shall be and become a part of said trust estate, it being our hope that all of the earnings and income of said trust estate during the period of this trust may be used to augment the trust estate and be delivered to our said Grandson at the periods herein provided for. *It is expressly provided, however, that our said Grandson shall be properly maintained*, educated and supported, and *if it be necessary to use all of the income and even all of the corpus* of the trust estate hereby created and all augmentations thereof, *it shall be the duty of the Trustee to see that this obligation shall be properly and reasonably discharged*. . . . [Emphasis added]

In view of the apparently conflicting terms of this article for use of the corpus, the exact scope of the trustee's discretion is by no means clear. But this need not be determined. Whether the disposition is in his judgment entirely, as the first clause indicates, or under the second is so only with reference to how much of the fund may be needed,[8] the trustee cannot act in any case to apply corpus or income for the support, maintenance and education of the beneficiary until necessity arises.

Under the particular facts, this requirement is important in two respects. It is, as petitioners urge, a limitation upon the trustee's discretion. His power is not unconfined. Even though the existence and amount of need may be in the first instance for his determination, it does not follow that, need existing, the trustee arbitrarily could refuse to make the application. The case therefore is not one in which present enjoyment is dependent upon an exercise of the trustee's absolute discretion.

[8] Petitioner presents the case as if no discretion whatever were vested in the trustee as to making the payments over. However, in the first provision for use of the corpus such use is authorized "if it be necessary . . . and in the judgment of the Trustee it is best to do so"; in the other provision the duty imposed, "if it be necessary to use all of the income and even all of the corpus," is one "to see that this obligation shall be properly and reasonably discharged." If the first clause limits the second, the trustee's discretion is bounded only by what he thinks "it is best to do," and in any event under the latter his duty is only to see that the obligation is "properly and reasonably" discharged. Presumably also the trustee would have some room for judgment on whether particular circumstances would amount to necessity and particular measures would be required to meet it.

But this does not show, as petitioners seem to think, that the minor beneficiaries had, at the moment of the gift, a present right of enjoyment. It rather shows the contrary—that their right was not absolute and immediate, but was conditioned, during minority and afterward until the times specified for distribution, upon a contingency which might never arise. That contingency, by the explicit terms of the trust, was the existence of need which was then nonexistent and, in the stated contemplation of the donors, was not likely to occur in the future, at any rate during the child's minority. The circumstances surrounding the donors and the donees confirm these recitals. The case is one therefore in which the gift, if presently vested, made enjoyment contingent upon the occurrence of future events, not only uncertain, but by the recitals of the instrument itself improbable of occurrence. The gifts consequently were of "future interests in property" within the meaning of Section 504(b).

Petitioners' contrary argument, apart from the misconception that legal vesting of the interest without more satisfies the statute,[9] rests chiefly upon considerations arising from the legislative history and from the fact that gifts for the benefit of children under legal disability to manage their own property must make provision for its control by trustees or otherwise.

Special stress is placed on the fact that each gift was made to or for the benefit of a specifically named beneficiary then in esse and for a definite amount. As the *Pelzer* opinion noted, 312 U. S. at 403, the committee reports recommending the legislation stated: "The exemption being available only in so far as the donees are ascertainable, the denial of the exemption in the case of gifts of future interests is dictated by the apprehended difficulty, *in many instances*, of determining the number of eventual donees and the values of their respective gifts."[10] (Emphasis added.) And in the *Pelzer* case the Court found that the gift involved these difficulties, as well as postponement of enjoyment to the happening of a future uncertain event, since the right of enjoyment was contingent in any event upon the beneficiaries' surviving the ten year period specified for accumulation of income. 312 U. S. at 404.

[9] Several of petitioners' statements of their contentions ignore the contingency upon which enjoyment is deferred in this case, namely the occurrence at some future time of the need or necessity of the beneficiary which would bring the trustee's power or duty to provide for support or maintenance from the trust fund into play. It is not necessary to note these contentions specifically further than to say, in addition to what has been said already, that they assume as the answer to it the very issue in the case.

[10] H. Rep. No. 708, 72d Cong., 1st Sess., 29; S. Rep. No. 665, 72d Cong., 1st Sess., 41.

Both conclusions would seem applicable in this case, the chief difference being that the period of postponement, which the beneficiaries must survive before enjoyment begins, is indefinite rather than for a specified time. That is true in any case where the length of the period is governed by a contingency. But the regulation, adopted almost in the language of the committee reports,[11] does not limit the denial of the exemption to instances where the deferment of enjoyment is at all events for a period which is definite and certain. Cf. *Commissioner* v. *Glos*, 123 F. 2d 548, 550. Clearly the statute is not to be applied differently, to grant or deny the exemption, if there is postponement, merely because in one case the period is under any eventuality for a certain, specified length of time, whereas in another it is of uncertain or indefinite length. The important thing is the certainty of postponement, not certainty of the length of its duration.

Furthermore, if there is postponement, the exemption is denied whether or not the administrative difficulties anticipated in the committee reports inhere in the particular gift. *Commissioner* v. *Glos*, *supra*; *Welch* v. *Paine*, 120 F. 2d 141. Those reports specifically state these difficulties are present "in many instances." But they also state that "the term 'future interests in property' refers to *any* interest or estate, whether vested or contingent, limited to commence in possession or enjoyment at a future date."[12] They thus contemplate, as does the regulation framed in similar terms, vested as well as contingent interests and estates. And there is nothing to indicate that gifts to specified donees in esse and in definite amounts are to be excluded from the denial, if by the terms of the gift enjoyment is deferred to a future time. Again, the crucial thing is postponement of enjoyment, not the fact that the beneficiary is specified and in esse or that the amount of the gift is definite and certain.[13]

The considerations, which petitioners advance to support their position, from the minority of the beneficiaries and their consequent legal disability to manage and control their property are intermingled with others relating to the motives of the donors in

[11] Cf. text at note 12 *infra*.

[12] Cf. note 10 *supra*.

[13] The absence of these factors is relevant as showing the more clearly that postponement exists and therefore the exemption does not apply. Their presence does not show that there is no postponement or that the exemption applies. The administrative difficulties relating to these matters "in many instances" were reasons for denying the exemption. They do not and were not intended to encompass the full scope of the denial. As the statute extended the exemption, "in the specified amount," to all gifts, whether large

making the gifts. It is said that their purpose was to provide for the "comfort, support, maintenance and welfare," including education, of the grandchildren; that the latter were incapable of taking over the management and control of the property; that accordingly it was necessary for some arrangement to be made for vesting this power in trustees or others capable of exercising it; that the trustees were given no power to withhold either income or corpus in case of need; and consequently the whole fund became available to the beneficiary for his maintenance "immediately upon the consummation of the gift," so that he was vested at once with the right of present enjoyment as fully as any child of tender years could be and in no way differently, taking account of his disability, than any owner of property by title in fee simple.

So far as the argument turns on the motive of the donors, it may be answered that the statute and the regulation make no such test. If motive has bearing, it is only by reason of its effect upon the element of time and whatever relation may be given, by the particular terms of the gift, to it and the disclosing of a purpose to provide for or against immediate enjoyment. The statute in this respect purports to make no distinction between gifts to minors and gifts to adults. If there is deferment in either case the exemption is denied. Consequently in this case the donors' laudable desire to make provision for their grandchildren in case of future need cannot nullify the deferment which the recited absence of present need, coupled with the terms of the trust, brought about. Again, contingency of need in the future is not identical with the fact of need presently existing. And a gift effective only for the former situation is not effective, for purposes of relief from the tax, as if the latter were specified, whether the donee is an adult or a minor.

Upon the facts, furthermore, the trusts hardly can be taken as designed primarily for the periods covered by the children's minority. They did not terminate with the ending of that period. The graduated scale of payments, beginning at age twenty-five and ending at thirty-five, together with the prohibition of payment earlier except in case of necessity, shows principal concern for a period of adult life. And, from the fact that this would be the period when the grandchildren normally would be assuming family

or small, 'made to any person,' " Helvering *v.* Hutchings, 312 U. S. 393, 397, so it denied the exemption to all gifts, whether large or small, vested or contingent, made to any person, whether specified and in esse or ascertainable only in the future, and whether for a specific or a presently unascertainable amount, if the gift is one of a "future interest in property," that is, one as to which enjoyment is postponed to some future time.

responsibilities of their own, the inference well might be drawn that the chief purpose was to give aid and some security in that time. The contingent provision, in case of earlier need, cannot be taken therefore to represent the donors' primary concern as expressed in the instruments. Cf. *Fisher* v. *Commissioner*, 132 F. 2d 383, 386. But, whether so or not, in the particular circumstances that need was but a contingency to be realized, if at all, in the future. And, until realized, the contingency stood squarely in the way of any child's receiving a single dollar from the fund.

Finally it is urged that unless these gifts are to be taken as conferring the right to immediate enjoyment, no gift for the benefit of a child of tender years can be so regarded since in any such case "some competent person must be the primary judge as to the necessity and extent of reasonable requirements of the beneficiary." The argument is appealing, in so far as it seeks to avoid imputing to Congress the intention to "penalize gifts to minors merely because the legal disability of their years precludes them for a time from receiving their income in hand currently." Cf. *Disston* v. *Commissioner*, 144 F. 2d 115, 119. But we think it is not applicable in the facts of this case, since by the terms of the trusts and the facts recited in the instruments none of the fund, whether income or corpus, could be applied immediately for the child's use or enjoyment.

It does not follow, as petitioners say, that if the exemption does not apply in this case it can apply in no other made for a minor's benefit. Whenever provision is made for immediate application of the fund for such a purpose, whether of income or of corpus, the exemption applies. Whether, in the case of a gift requiring such an application of the income, but providing for retention of a corpus no more than reasonably sufficient to produce the income required for this purpose and to insure its continued payment during minority, the donation would fall within the exemption, as to corpus as well as income, is a question not presented on this record and therefore not determined.

The regulation has received the construction now reaffirmed with substantial consistency. The statute, with the meaning thus settled, has been reenacted by Congress.[14] The construction should be followed until Congress sees fit to change it.

The judgment is

Affirmed.

[14] Congress withdrew the exclusion, as to gifts in trust, in the Revenue Act of 1938, c. 289, 52 Stat. 447, § 505, amending § 504(b) of the 1932 Act. But it was restored, though reduced to $3,000, by the Revenue Act of 1942, c. 619, 56 Stat. 798, §454.